

Form 10-K

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal years ended December 31, 2003 and 2002,
including a restatement of previously issued consolidated financial statements
for the fiscal years ended December 31, 2001 and 2000**

Commission File Number 1-10315

HealthSouth Corporation
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

63-0860407
(I.R.S. Employer Identification No.)

One HealthSouth Parkway
Birmingham, Alabama
(Address of Principal Executive Offices)

35243
(Zip Code)

Registrant's Telephone Number, Including Area Code: (205) 967-7116

Securities Registered Pursuant to Section 12(b) of the Act:

None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$.01 Par Value

Indicate by check mark whether the registrant (1) has filed all Reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such Reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☒

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

As of May 31, 2005, there were outstanding 397,063,445 shares of common stock of the registrant, net of treasury shares. As of June 30, 2004, the aggregate market value of common stock held by nonaffiliates was approximately \$2.3

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outstanding capital stock of CMS, and an NEA affiliate owned approximately 28% of the outstanding capital stock of CMS. C. Sage Givens and Michael D. Martin were also CMS directors. From 2000 through 2003, HealthSouth purchased services from CompHealth, Inc., CMS's wholly owned subsidiary, in the following amounts: 2000 (\$187,000), 2001 (\$354,000), 2002 (\$844,000), and 2003 (\$523,000). In 2003, we sold our remaining interests in CMS for approximately \$16 million.

HealthTronics, Inc.

In August 1999, we invested approximately \$3 million in HealthTronics, Inc., a publicly traded specialty medical product company, in exchange for 500,000 shares, which constituted approximately 4% of the company's outstanding capital stock. In November 1999, we transferred 83,334 of our HealthTronics shares to Richard M. Scrushy. We have no record of Mr. Scrushy paying any money for these shares. Michael D. Martin served on the board of directors of HealthTronics. From 2000 through 2003, we purchased medical equipment and related supplies from HealthTronics in the following amounts: 2000 (\$330,000), 2001 (\$471,000), 2002 (\$891,000), and 2003 (\$826,000).

MedCenterDirect.Com, Inc.

In 1999, we acquired 6,390,583 shares of Series A Preferred Stock of MedCenterDirect.com, Inc. ("MCD") for a total purchase price of approximately \$2.2 million. At the time of our initial investment, certain of our directors, executive officers, and employees also purchased shares of MCD's Series A Preferred Stock, directly or indirectly through one or more of their affiliates, for a total purchase price of approximately \$3.4 million. In 2000, an NEA fund purchased 4,800,000 shares of MCD's Series E Preferred Stock through one of its funds for a total purchase price of \$12 million. Charles W. Newhall III served on MCD's board of directors.

The following table sets forth the approximate ownership of MCD by HealthSouth directors, executive officers, and employees, directly or indirectly through one or more of their affiliates, on a fully diluted basis (i.e., assuming the exercise of all outstanding options and warrants and issuance and exercise of all reserved options). The ownership is calculated as of December 31, 1999, which was shortly after MCD's initial capitalization, and as of December 31, 2002, which was the end of the last full year of MCD's operations. MCD discontinued operations in 2003.

	December 31, 1999	December 31, 2002
HealthSouth	29.8%	20.2%
Richard M. Scrushy ⁽¹⁾	28.3%	20.6%
New Enterprise Associates 9, L.P.	0.3%	14.7%
HealthSouth Directors ⁽²⁾	7.2%	4.7%
HealthSouth Executive Officers ⁽³⁾	3.4%	2.1%
HealthSouth Employees	6.3%	4.7%
Total	75.3%	67.0%

- (1) Mr. Scrushy invested approximately \$2.1 million in MCD indirectly through an investment partnership and a charitable foundation.
- (2) Includes investments made directly or indirectly by James P. Bennett, P. Daryl Brown, John S. Chamberlin, C. Sage Givens, Joel C. Gordon, Michael D. Martin, Larry D. Striplin, Jr., George H. Strong, and Phillip C. Watkins, each of whom was a HealthSouth director in 1999. Does not include investments made indirectly by Richard M. Scrushy or investments made by New Enterprise Associates 9, L.P.
- (3) Includes investments made directly or indirectly by Thomas W. Carman, Patrick A. Foster, William W. Horton, William T. Owens, Daniel J. Riviere, and Robert E. Thomson, each of whom was a HealthSouth executive officer in 1999. Does not include Richard M. Scrushy, who was also a HealthSouth executive officer in 1999.

Table of ContentsIndex to Financial Statements*Source Medical Solutions, Inc.*

In April 2001, we established Source Medical Solutions, Inc. ("Source Medical") and acquired 3,932,500 shares of Source Medical's common stock for a total purchase price of \$393,250. At the time of our initial investment, certain of our directors, executive officers, and employees also purchased shares of Source Medical's common stock for a total purchase price of approximately \$600,000. Richard M. Scrushy, William T. Owens, Brandon O. Hale, and P. Daryl Brown were each directors of Source Medical.

The following table sets forth the approximate ownership of Source Medical by HealthSouth directors, executive officers, and employees. The ownership is calculated as of April 23, 2001, which was shortly after Source Medical's initial capitalization.

	April 23, 2001
HealthSouth	35.75%
Richard M. Scrushy ⁽¹⁾	13.64%
P. Daryl Brown	9.10%
William T. Owens ⁽¹⁾	4.55%
HealthSouth Executive Officers ⁽²⁾	7.39%
HealthSouth Employees	20.50%
Total	90.93%

- (1) Following the initial capitalization of Source Medical, but prior to December 31, 2002, Mr. Scrushy and Mr. Owens transferred all their Source Medical common stock to the HealthSouth Sports Medicine Council, a nonprofit entity affiliated with us. The shares were transferred by gift, with no consideration paid to Mr. Scrushy or Mr. Owens.
- (2) Includes Thomas W. Carman, Patrick A. Foster, Brandon O. Hale, William W. Horton, Susan M. Jones, Malcolm E. McVay, Weston L. Smith, Larry D. Taylor, and Robert E. Thomson, each of whom was an executive officer of HealthSouth in 2001. Does not include Richard M. Scrushy or William T. Owens, each of whom was also a HealthSouth executive officer in 2001.

Source Medical was created to continue development and allow commercial marketing of a wireless clinical documentation system originally developed by HealthSouth. This proprietary software was referred to internally as "HCAP" and was later marketed by Source Medical under the name "TherapySource." Source Medical acquired HCAP assets, including intellectual property rights to the technology, pursuant to an Asset Purchase Agreement and a Non-Negotiable Demand Note for \$25 million, both dated July 1, 2001. Total amounts advanced by HealthSouth to Source Medical to continue to develop HCAP and to fund other operations and acquisitions were approximately \$81.3 million in 2001, \$31.5 million in 2002, and \$11.8 million in 2003. In connection with one of Source Medical's acquisitions during 2001, we also guaranteed certain contingent payment obligations of Source Medical to the sellers of \$6 million. During the restatement period, Source Medical was dependent on HealthSouth for the majority of its revenues and funding.

In addition, during 2002 Source Medical borrowed \$5 million for working capital from an unrelated third-party financial institution. HealthSouth guaranteed this loan. In March 2003, the loan was called and we were required to pay \$5.1 million to repay the loan, including interest, on behalf of Source Medical. We have reserved \$5.1 million as an uncollected amount due from Source Medical.

The majority of our loans and advances to Source Medical have been excused in debt restructuring agreements to facilitate recapitalization efforts. Our ownership has also been diluted to approximately 7% as part of these recapitalizations and to accommodate new investment from unrelated parties. We continue to lease HCAP software from Source Medical for approximately \$4.2 million annually and we remain Source Medical's primary customer. We believe that the licensing terms are as favorable as we could have received from an

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Richard M. Scrushy, Michael D. Martin and Larry D. Striplin, Jr. were initial directors of Capstone. Mr. Scrushy was also Chairman of the Board of Capstone. In November 1998, HealthCare Realty Trust acquired Capstone, and it ceased independent operations.

First Cambridge HCI Acquisitions, LLC

In December 2001, HealthSouth entered into an agreement with HealthCare Capital Investors, LLC ("HCI") to sell and lease back land, buildings, and improvements associated with 13 HealthSouth facilities. The sale price for the property was approximately \$81.5 million. Immediately following that transaction, HCI assigned all its rights and duties under the sale-leaseback agreement to First Cambridge. On the same day, we signed a master lease agreement with First Cambridge to lease back the 13 real properties from First Cambridge for 15 years. On December 27, 2001, First Cambridge financed this transaction with UBS AG ("UBS") with the proceeds from an \$82.5 million promissory note. We guaranteed First Cambridge's debt for the financing of this transaction. During 2002, we paid approximately \$9.5 million to First Cambridge under the terms of the master lease agreement.

First Cambridge was a partnership established by five members of our senior management team and two outside investors. The following table sets forth the approximate ownership of First Cambridge by HealthSouth directors, executive officers, and officers at the time of the sale-leaseback transaction.

	December 31, 2001
Richard M. Scrushy ⁽¹⁾	20%
William T. Owens	10%
William W. Horton	5%
Malcolm E. McVay	5%
Weston L. Smith	5%
Richard Davis ⁽²⁾	3%
Jason M. Brown	1%
Total	49%

(1) Shares held in Mr. Scrushy's daughter's name.

(2) Shares held in Mr. Davis' brother's name.

First Cambridge defaulted on its loan to UBS and UBS demanded payment from HealthSouth under the terms of the guarantee agreement. As a result, we entered into a subsequent repurchase agreement with First Cambridge to effectively unwind the original agreement at a cost of \$87.5 million. The repurchase agreement provided for our payment of approximately \$82.5 million to UBS to repay the First Cambridge loan and our payment of approximately \$5 million to First Cambridge to repurchase the 13 HealthSouth facilities originally sold to First Cambridge. We recognized an \$8.8 million loss on payment of the UBS loan guarantee reflecting the difference between the amount due to First Cambridge and the amount paid to UBS on December 30, 2002.

Transactions Involving Vendors*AmerisourceBergen Corporation*

From 2000 to 2003, we purchased pharmaceutical supplies from AmerisourceBergen Corporation (which was created through the 2001 merger of AmeriSource Health Corp. and Bergen Brunswig Corp.) in the following amounts: 2000 (\$65,798,730), 2001 (\$64,957,559), 2002 (\$66,970,374), and 2003 (\$86,172,715). George H. Strong was a director of AmeriSource Health Corp. from 1992 until its merger with Bergen Brunswig Corp. in 2001.